ENTREPRENEURIAL FIRM EXIT: THE MODERATING EFFECT OF GOAL SPECIFICITY ON ESCALATION OF COMMITMENT (SUMMARY)

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**Recommended Citation**  
Khavul, Susanna; Markoczy, Livia; Croson, Rachel T.A.; and Yitshaki, Ronit (2011) "ENTREPRENEURIAL FIRM EXIT: THE MODERATING EFFECT OF GOAL SPECIFICITY ON ESCALATION OF COMMITMENT (SUMMARY)," *Frontiers of Entrepreneurship Research: Vol. 31 : Iss. 3 , Article 6.*  
Available at: https://digitalknowledge.babson.edu/fer/vol31/iss3/6

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ENTREPRENEURIAL FIRM EXIT: THE MODERATING EFFECT OF GOAL SPECIFICITY ON ESCALATION OF COMMITMENT

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Principal Topic

Although much is known about market entry decisions, little is known about the decision of an unprofitable firm to exit. Prior research has identified economic and strategic barriers to exit but has largely neglected behavioral ones. We suggest that the psychology of the decision-maker may also act as a barrier to exit and engender escalation of commitment behavior. We take a behavioral approach and use multiple methods (observational and experimental) to understand escalation of commitment in the context of entrepreneurial firm exit. Our paper shows that financial and human capital create sunk costs that act as barriers to exit. With respect to financial capital, we argue and show that sunk costs generated with either equity or debt engender escalation behavior but for different reasons. Likewise, investment in human capital can create sunk costs that also motivate escalation behavior. Nevertheless, some decision makers do overcome the tendency to escalate sooner than others. This raises questions about whether there are de-biasing strategies that managers can use to overcome escalation of commitment in their decisions to exit. We show that establishing specific goals curbs escalation of commitment behavior and hastens exit. Our study suggests that managers and entrepreneurs can improve their decision-making by setting specific goals as a de-biasing strategy.

Method

Our observational data consists of in-depth structured survey of 92 failed high technology firms. We followed up the observational study with an experiment in which 453 individuals participated. The experimental protocol contained eight versions of a financing decision to which participants were randomly assigned. The amount invested in a venture, the time remaining to completion, and goal specificity varied across the eight conditions. Our multi-method approach ensures realism and external validity (from the field test), and excludes confounding variables and addresses endogeneity (from the laboratory test).

Results and Implications

The results of our study are consistent across observational and experimental data. What we observed in the field we reproduced in the lab; thus, strengthening our findings. Investments in financial and human capital create a psychological barrier to exit and promote escalation behavior. Specific goals attenuate the escalation dynamic and act as a de-biasing technique.

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